Supreme Court, U.S.
FILED
APR 24 1995
OFFICE OF THE CLERK

No. 94-1577

In The

Supreme Court of the United States

October Term, 1994

FBT BANCSHARES, INC.,

Petitioner,

v.

THE MUTUAL FIRE, MARINE AND INLAND INSURANCE COMPANY (IN REHABILITATION),

Respondent.

Petition For Writ Of Certiorari To The Supreme Court Of Pennsylvania

BRIEF IN OPPOSITION

RICHARD DISALLE, Esquire
Counsel of Record
MARY LYNCH FRIEDLINE, Esquire
ROSE, SCHMIDT, HASLEY & DISALLE, P.C.
900 Oliver Building
Pittsburgh, PA 15222-2310
(412) 434-8600

Attorneys for Respondent, Linda S. Kaiser, Insurance Commissioner of the Commonwealth of Pennsylvania, as Rehabilitator of The Mutual Fire, Marine and Inland Insurance Company

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

30 PP

BEST AVAILABLE COPY

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

(1) Where Petitioner chose not to participate in Pennsylvania court proceedings (held over five years ago) addressing the validity of the Mutual Fire Plan of Rehabilitation, and did not file a petition asking this Court to review the Pennsylvania Supreme Court's approval of the Plan, should the Petition for Writ of Certiorari, which seeks belatedly to challenge the validity of the Plan, be denied?

(2) Where the sole issue presented is whether, as applied to Petitioner (a judgment creditor of Mutual Fire), Section XVII of the Mutual Fire Plan of Rehabilitation is constitutionally infirm – an issue that was raised by other creditors more than five years ago, and addressed and decided by Pennsylvania's highest Court – and where Petitioner intentionally chose not to participate in those proceedings, should the Petition for Writ of Certiorari be denied?

(3) Where the Pennsylvania Supreme Court, in addressing the validity of the Plan's prohibition against payment of interest, has held that the Rehabilitator's equitable powers under Pennsylvania law and the state's significant interest in assuring equitable apportionment of unavoidable loss in the context of insurer rehabilitations clearly afford her the authority to limit *or deny* interest on judgments which were entered after the Petition for Rehabilitation had been filed, should the Rehabilitator's action, which denied interest on a post-rehabilitation judgment, be rescinded?

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED – Continued

(4) Where the Petitioner has no "contractual" rights to assert, should Petitioner's argument that the Mutual Fire Plan of Rehabilitation violates the Contract Clause be addressed?

TABLE OF CONTENTS

Page

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED i

TABLE OF AUTHORITIES v

COUNTERSTATEMENT OF THE CASE 1

REASONS FOR REFUSAL OF THE WRIT 10

I. SECTION XVII OF THE PLAN, WHICH WAS EXPRESSLY APPROVED BY THE PENNSYLVANIA SUPREME COURT, PRECLUDES FBT FROM RECOVERING INTEREST ON ITS CLAIM 10

A. The Pennsylvania Supreme Court's Ruling in Connection with Pepsi-Cola's Appeal from the Plan Is Dispositive in This Case 10

B. FBT Has Waived Any Right It May Have Had to Challenge the Plan 12

II. FBT'S CONSTITUTIONAL CHALLENGES ARE MERITLESS 13

A. Section XVII Does Not Impair Any "Contractual Rights" of FBT 13

B. The Plan's Prohibition Against Interest Payments Does Not Violate Any Due Process Rights of FBT 15

C. The Rulings of the Commonwealth Court and the Pennsylvania Supreme Court Which Prevent FBT From Seeking Interest From the Insolvent Mutual Fire Estate Do Not Violate the Full Faith and Credit Clause 17

TABLE OF CONTENTS – Continued

Page

D. The Plan's Prohibition Against Interest Is Wholly Consistent With the General Rule That Interest on a Debtor's Obligation Ceases When Receivership Proceedings Commence 19

CONCLUSION 23

TABLE OF AUTHORITIES

Page

CASES:

American Iron & Steel Manufacturing Co. v. Seaboard Air Line Railway, 233 U.S. 261, 34 S. Ct. 502, 58 L.Ed. 949 (1914) 19, 20, 21

Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 103 S. Ct. 697, 74 L.Ed.2d 569 (1983) 14

Foster v. The Mutual Fire, Marine and Inland Insurance Company, 531 Pa. 598, 614 A.2d 1086 (1992), *cert. denied sub nom. Allstate Insurance Company v. Maleski*, 506 U.S. ___, 113 S. Ct. 1047, 122 L.Ed.2d 356 (1993) and *Republic Insurance Group v. Maleski*, 506 U.S. ___, 113 S. Ct. 1066, 122 L.Ed.2d 371 (1993) ..... *passim*

Grode v. The Mutual Fire, Marine and Inland Insurance Company, 132 Pa. Commw. 196, 572 A.2d 798 (1990) 3, 4

In re D.C. Sullivan, 929 F.2d 1 (1st Cir. 1991) 21

In re Sublett, 895 F.2d 1381 (11th Cir. 1990) 21

Mathews v. Eldridge, 424 U.S. 319, 96 S. Ct. 893, 47 L.Ed.2d 18 (1976) 16

Morris v. Jones, 329 U.S. 545, 67 S. Ct. 451, 91 L.Ed. 488 (1947) 8, 11, 12, 17, 18, 19

John Nicholas, Trustee v. United States, 384 U.S. 678, 86 S. Ct. 1674, 16 L.Ed.2d 853 (1966) 20

Ticonic National Bank v. Sprague, 303 U.S. 406, 58 S. Ct. 612, 82 L.Ed. 926 (1938) 21

United States v. Ron Pair Enterprises, 489 U.S. 235, 109 S. Ct. 1026, 103 L.Ed.2d 290 (1989) 19

TABLE OF AUTHORITIES – Continued

Page

Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 67 S. Ct. 237, 91 L.Ed. 162 (1946)... 19, 20, 21

Vickodil v. Commonwealth Insurance Dept., 126 Pa. Commw. 390, 559 A.2d 1010 (1989) 14

Yick Wo v. Hopkins, 118 U.S. 356, 6 S. Ct. 1064, 30 L.Ed. 220 (1886) 16

UNITED STATES CONSTITUTION:

Article 1, Section 10 (Contracts Clause) 13

Article 4, Section 1 (Full Faith and Credit Clause) 17

Fourteenth Amendment (Due Process Clause) 15

STATUTES/RULES:

Pennsylvania Insurance Department Act

40 P.S. § 221.1(c)..... 3

40 P.S. § 221.15..... 2

40 P.S. § 221.16..... 3

Pennsylvania Rule of Appellate Procedure 910 15

COUNTERSTATEMENT OF THE CASE

Respondent is Linda S. Kaiser, Insurance Commissioner of the Commonwealth of Pennsylvania, as Statutory Rehabilitator ("Rehabilitator") of The Mutual Fire, Marine and Inland Insurance Company ("Mutual Fire").[1] Petitioner FBT, a judgment creditor, has already received full payment of its 1990 judgment in the amount of $1 million from the insolvent Mutual Fire estate, and now seeks an additional $1.2 million in interest calculated from the date FBT commenced its lawsuit, August 19, 1986. The Plan of Rehabilitation under which Mutual Fire operates prohibits payment of interest.

The instant Petition raises the same arguments that were presented by other creditors in the Pennsylvania courts and in this Court by way of Petitions for Certiorari seeking review of the Pennsylvania Supreme Court's August 21, 1992 Order approving the Plan of Rehabilitation. *Foster v. The Mutual Fire, Marine and Inland Insurance Company*, 531 Pa. 598, 614 A.2d 1086 (1992), *cert. denied sub nom. Allstate Insurance v. Maleski*, 506 U.S. ___, 113 S. Ct. 1047, 122 L.Ed.2d 356 (1993) and *Republic Insurance Group v. Maleski*, 506 U.S. ___, 113 S. Ct. 1066, 122 L.Ed.2d 371 (1993). (Although it had full opportunity to do so, FBT did not participate in any of the Pennsylvania Court proceedings, nor did it file a petition in this Court.)

---

[1] Mutual Fire has no parent company. Mutual Fire's subsidiaries, as defined by Sup. Ct. R. 29.1, are: Endmark Data Processing Corporation; Ryansure Intermediaries, Inc.; Cable Life Insurance Co.; UMI Asset Management; and UMI Holdings. Petitioner FBT Bancshares, Inc. ("FBT") incorrectly designates respondent as Mutual Fire, Marine and Inland Insurance Company, *Inc.*

The Pennsylvania Insurance Department commenced summary receivership proceedings against Mutual Fire on June 13, 1986, when it issued a "supervision order" severely restricting Mutual Fire's ability to conduct business. On September 12, 1986, the Insurance Commissioner of the Commonwealth of Pennsylvania issued an Order which, *inter alia*, prohibited Mutual Fire from conducting further business and stayed all actions and proceedings against Mutual Fire and its assets (the "Suspension Order"). On December 8, 1986, the Commonwealth Court of Pennsylvania, which is assigned jurisdiction over, and supervisory responsibility for, insurance rehabilitations and liquidations, entered an Order placing Mutual Fire into rehabilitation and appointing the Insurance Commissioner of the Commonwealth of Pennsylvania as Rehabilitator pursuant to the Pennsylvania Insurance Department Act (the "Act"), 40 P.S. § 221.15.

On August 19, 1986, FBT, Fidelity Bank & Trust Co. ("Fidelity Bank") and FBT's principal shareholders filed suit in Louisiana state court against Mutual Fire, Shand, Morahan & Co., Alexander & Alexander, and Charles B. Faler, a former president of Fidelity Bank and shareholder of FBT, alleging that Faler caused Fidelity Bank losses of $103,700 through admittedly unauthorized loans. (A-7.)[2] Mutual Fire had issued a director's and officer's liability policy in 1983 (with liability limits of $1,000,000) to Fidelity Bank and its officers and directors.

---

[2] References to the Appendix in the Petition are designated as "A-___."

Petitioner FBT (a bank holding company and Fidelity's sole shareholder) was also named as an insured on the policy.

Significantly, on September 15, 1986, *after* entry of the Suspension Order by the Pennsylvania Insurance Department staying all actions and proceedings against Mutual Fire, FBT filed an "Amended Petition" in the Louisiana Court, identifying additional unauthorized loans made by Faler and claiming damages of $1,730,297.61, "together with legal interest thereon as provided by law." (A-7.)

1. FBT Failed to Appeal the Mutual Fire Plan of Rehabilitation, Which Prohibits Creditors from Seeking Interest.

The stated purpose of Article V of the Insurance Act, which governs the rehabilitation and liquidation of insolvent insurance companies in Pennsylvania, is "the protection of the interests of insureds, creditors, and the public generally" through, *inter alia*, "equitable apportionment of any unavoidable loss." 40 P.S. § 221.1(c). The Act affords the Insurance Commissioner, as statutory rehabilitator, broad discretion and authority to take whatever action is deemed necessary to correct the conditions which gave rise to the rehabilitation Order, including the authority to formulate a plan for rehabilitating the insolvent insurance company. 40 P.S. § 221.16(b), (d).

On January 31, 1989, the Rehabilitator submitted a Plan of Rehabilitation for Mutual Fire to the Commonwealth Court. *Grode v. The Mutual Fire, Marine and Inland Insurance Company*, 132 Pa. Commw. 196, 572 A.2d 798

(1990). The Plan dictates, *inter alia*, how and when creditors' claims are to be presented in the rehabilitation and the priority or class assigned to creditors' claims, including a procedure for the proportional payment (over a period of years) of Class 4 policyholder claims. In particular, Section XVII of the Plan, which Petitioner seeks to challenge in this Court, expressly prohibits payment of interest to creditors:

> Except as may be otherwise provided for in this Plan, or as may be otherwise required under applicable law, *all Creditors holding Unsecured Claims shall waive interest*, late charges, penalties, attorneys' fees and court costs against Mutual Fire and the Rehabilitator . . . . (Emphasis added.)

On March 7, 1989, copies of the proposed Plan, notice of its filing and of creditors' rights to file objections or responses thereto, and a Plan summary were served upon all creditors, policyholders and claimants, including Petitioner. Many creditors filed objections to the Plan with the Commonwealth Court. *FBT did not*. The Commonwealth Court conducted four days of hearings in July and August of 1989, *but FBT chose not to participate*.

By Opinion and Order dated January 23, 1990, the Commonwealth Court approved the Plan, with certain modifications. *Grode, supra*. Numerous creditors appealed that Order to the Pennsylvania Supreme Court. *FBT did not*. In fact, another judgment creditor, Pepsi-Cola Bottling Company of Charlotte, North Carolina appealed and specifically challenged Section XVII of the Plan, arguing that it was entitled to payment of interest on its

judgment.[3] *Foster*, 614 A.2d at 1101. FBT chose not to join or participate with Pepsi-Cola in that appeal.

By Opinion and Order dated August 21, 1992, a unanimous Pennsylvania Supreme Court approved the Rehabilitation Plan in all material respects. Significantly, in considering the Pepsi-Cola appeal, the Pennsylvania Supreme Court upheld Section XVII of the Plan as a proper exercise of the Rehabilitator's equitable powers, which clearly afford her the authority *"to limit or deny interest which accrues after a petition for rehabilitation or liquidation has been filed . . . ."* *Foster*, 614 A.2d at 1102 (emphasis added). The Court concluded that Pepsi-Cola's judgment entitled it to receive interest *only* through and until December 4, 1986, the date the Insurance Commissioner filed the Petition for Rehabilitation. *Id.*

2. FBT's Claim Against Mutual Fire in Louisiana State Court

The Rehabilitator defended the Louisiana state court suit against Mutual Fire on the basis that the policy's cross-insured exclusion, which precludes recovery under the policy by one insured for the conduct of another, precluded FBT (as an insured) from recovery on the policy as a result of the conduct of Faler (a co-insured). Both Mutual Fire and FBT eventually filed motions for summary judgment in the Louisiana action. In connection

---

[3] Pepsi-Cola held a federal court judgment against Mutual Fire, entered in September of 1986 (prior to entry of the Rehabilitation Order), which included an award of interest at 8% per annum from the date of the contract breach, May 21, 1986. *Foster*, 614 A.2d at 1101-1102.

with its motion, FBT sought, for the first time, reformation of the six-year-old Mutual Fire policy *to exclude* FBT as an insured, alleging that its inclusion on the policy was in error.

On June 28, 1990, the Louisiana Court granted FBT's Motion, and in addition to reforming the policy to exclude FBT as an insured, found that FBT suffered losses in excess of the $1,000,000 policy limits and entered judgment against Mutual Fire for $1,000,000 "together with legal interest from date of judicial demand until paid." (A-2.) The amount of "legal interest" was never calculated by the Louisiana Court or entered on the record as part of the judgment.

Mutual Fire appealed the summary judgment order to the Louisiana Court of Appeal, which affirmed the decision of the trial court. Certiorari was eventually denied by the Louisiana Supreme Court on September 4, 1992.

3. FBT's Claim Against Mutual Fire in the Commonwealth Court Rehabilitation Proceedings

On February 28, 1989, while its action against Mutual Fire was still pending in Louisiana state court, FBT filed a Proof of Claim in the rehabilitation proceedings in the amount of $1,730,297.61.[4] As stated, FBT was subsequently served with a copy of the proposed Plan of

---

[4] FBT never amended its claim in the rehabilitation although it reduced its claim from $1.7 to $1.3 million when it filed its Motion for Summary Judgment in the Louisiana state court.

Rehabilitation, but did not file any objections to the Plan or participate in the Plan hearings before the Commonwealth Court.

On October 2, 1992, pursuant to Section VII of the Plan, the Rehabilitator served FBT with a Notice of Determination ("NOD"), assessing the reasonable value of FBT's claim at $350,000. FBT then filed a Motion for Summary Judgment in the rehabilitation proceeding, arguing that FBT was *not* bound by Section XVII or any other provision of the Plan and that the rehabilitation court (the Commonwealth Court) was required to give effect to the Louisiana court's judgment awarding interest. FBT insisted that it was entitled to receive immediate payment not only of its $1 million judgment, but also interest from the date of the filing of its initial petition in Louisiana – August 19, 1986 – notwithstanding Section XVII of the Plan.

By Opinion and Order dated November 10, 1993, the Commonwealth Court granted FBT's Motion, in part, entering judgment in favor of FBT for the full amount of its judgment ($1 million); however, the Court denied FBT's claim for interest. With respect to the questions FBT now seeks to present for review by this Court, the Commonwealth Court made the following specific findings:

> (1) It was bound by the Pennsylvania Supreme Court's decision affirming the Plan,

and in particular, the provisions precluding payment of interest on creditor claims (A-11);

(2) The Pennsylvania Supreme Court allowed Pepsi-Cola interest on its *pre-rehabilitation* judgment, but only through December 4, 1986, the date rehabilitation was sought and the original Plan filed (A-11);

(3) Unlike Pepsi-Cola, FBT did not obtain its judgment until more than three years *after* the rehabilitation commenced (A-11);

(4) To allow FBT interest on its June 1990 judgment, when Pepsi-Cola was denied interest on a judgment which antedates the rehabilitation, would be in direct conflict with the holding of the Pennsylvania Supreme Court and "would be unreasonable, unsound and incongruous" (A-11);

(5) FBT was well aware of the rehabilitation, having filed a proof of claim in February of 1989, and could have appeared, as Pepsi-Cola did, to contest the Plan (A-11);

(6) FBT's failure to contest the Plan when it had the opportunity to do so over six years ago bars FBT from raising those issues now (A-11);

(7) Allowing FBT interest when it has been disallowed to other creditors would contravene *Morris v. Jones*, 329 U.S. 545 (1947), requiring parity among creditors (A-12).

FBT filed an appeal to the Pennsylvania Supreme Court claiming that it was entitled to immediate payment of its judgment plus an additional $1.2 million in interest

from the Mutual Fire estate.[5] On December 13, 1994, the Pennsylvania Supreme Court issued an Order affirming the Commonwealth Court's Order of November 10, 1993. In January 1995, FBT received payment from the Mutual Fire estate in the amount of $1 million.

FBT's assertions in its Petition concerning Mutual Fire's financial condition and its suggestions that the estate is solvent are self-serving and outrageous, and have no support in the record. According to Mutual Fire's publicly filed year-end 1994 financial statements, copies of which were furnished to FBT, Mutual Fire's current *deficit* is in excess of $400,000,000. Of the Company's $177 million in assets, approximately $150 million is encumbered or earmarked for specific reserve funds required to be established under the Plan, such as the fund for class 6 cedents (insurance companies which ceded business to Mutual Fire through reinsurance treaties) and a reserve of approximately $89 million for *unsettled* policyholder claims. Moreover, while all *settled and adjusted* policyholder claims have finally been paid in full, on a proportional basis, that does not represent *all* class 4 policyholder claims, as FBT suggests.

---

[5] It should be noted that while the legal rate of interest in Louisiana may not exceed 12%, it appeared that FBT had calculated its interest claim on the $1 million judgment at a much higher rate (15%-16%), or alternatively, on the full amount of its initial demand, $1.7 million.

REASONS FOR REFUSAL OF THE WRIT

I. SECTION XVII OF THE PLAN, WHICH WAS EXPRESSLY APPROVED BY THE PENNSYLVANIA SUPREME COURT, PRECLUDES FBT FROM RECOVERING INTEREST ON ITS CLAIM

A. The Pennsylvania Supreme Court's Ruling in Connection with Pepsi-Cola's Appeal from the Plan Is Dispositive in This Case.

The sole issue raised by FBT in its Petition – that the insolvent Mutual Fire estate should be required to pay interest on this particular creditor's judgment – has already been decided, first by the Commonwealth Court of Pennsylvania following extensive hearings, and ultimately, by the Pennsylvania Supreme Court in its August 21, 1992 Opinion approving the Plan. Moreover, since FBT did not initially object to the constitutionality of the Plan, nor appeal the Order approving the Plan five years ago when it had the opportunity to do so, it should not be permitted to raise those issues now.

As stated, Section XVII of the Plan was the subject of the 1990 appeal of Pepsi-Cola Bottling Company of Charlotte, North Carolina in the Pennsylvania Supreme Court, one of ten creditor appeals taken from the Order of the Commonwealth Court approving the Plan. Upon review, the Pennsylvania Supreme Court acknowledged that while Pepsi-Cola's pre-rehabilitation judgment, including interest, must be given dignity "up until December 4, 1986" (the date of filing of the rehabilitation petition), the Rehabilitator's equitable powers afford her the authority "to limit or deny interest which accrues *after a petition for*

rehabilitation or liquidation has been filed . . . ." *Foster*, 614 A.2d at 1102 (emphasis in original.)

Confronted with FBT's claim in the rehabilitation proceeding that it was entitled to interest (at the rate of at least 12% from the date it *commenced* the Louisiana suit, August 19, 1986), the Commonwealth Court concluded that the Pennsylvania Supreme Court's prior ruling on Section XVII was binding. The Commonwealth Court noted that, unlike Pepsi, FBT did not obtain its judgment until more than three years *after* December 4, 1986. Therefore, any award of interest to FBT would "be in direct conflict" with the Supreme Court's holding in connection with the Pepsi-Cola appeal "and would be unreasonable, unsound and incongruous." (A-11.) The Commonwealth Court further noted that awarding interest on FBT's post-rehabilitation judgment, when interest had been disallowed on claims of other creditors, "would run afoul of the dictates" of *Morris v. Jones*, 329 U.S. 345, 91 L.Ed. 488 (1947), which requires parity between in-state creditors and those of other states. (A-12.)

Clearly, the Pennsylvania Supreme Court's 1992 ruling in connection with Pepsi-Cola's appeal from Section XVII of the Plan is dispositive of FBT's interest claim. That Court agreed that the Rehabilitator's equitable powers clearly afford her the authority to limit *or deny* interest which accrues *after* a petition for rehabilitation has been filed, which is precisely what Section XVII of the Plan accomplishes. *Foster*, 614 A.2d at 1102. To the extent that a judgment awarding interest is entered against Mutual Fire *prior* to the rehabilitation petition, it must be accepted and given dignity up until December 4, 1986. *Id.*

FBT simply does not fall within that category; its judgment was entered in June 1990.

B. FBT Has Waived Any Right It May Have Had to Challenge the Plan.

The time for any creditor, especially FBT in this case, to challenge the Plan's provisions has long passed, as the Commonwealth Court noted at page 6 of its Opinion. (A-11.) FBT filed a Proof of Claim in excess of $1.7 million with the Rehabilitator in February of 1989, and it received a copy of the proposed Plan of Rehabilitation and a Notice stating, *inter alia*, that "any party in interest may file an answer, objection or other responsive pleading to confirmation and approval of the Plan." Significantly, attached to this was a "Summary of Plan of Rehabilitation" which included the following statement: "[n]o creditor will be entitled to interest on any claim."

FBT knowingly and intentionally chose not to file objections to the Plan; FBT also chose not to participate in the extensive Plan hearings conducted by the Commonwealth Court in the summer of 1989. Furthermore, FBT did not, as did Pepsi-Cola and other creditors, exercise its right to appeal the January 23, 1990 Order approving the Plan. *FBT did nothing*, and its instant Petition is simply a belated attempt to attack a provision of the Plan that has already been challenged by other creditors, the validity of which was addressed and approved by Pennsylvania's highest court almost three years ago.

II. FBT'S CONSTITUTIONAL CHALLENGES ARE MERITLESS

A. Section XVII Does Not Impair Any "Contractual Rights" of FBT.

Petitioner devotes extensive time and effort in its Petition to a discussion of the Contracts Clause of the United States Constitution (Article 1, Section 10). This argument makes no sense, however, since FBT is a judgment creditor and has no "contractual" rights which could be impaired by the Plan. Once the Louisiana state courts reformed the Mutual Fire policy by deleting FBT's name as an insured, FBT no longer had any contract to enforce. Furthermore, FBT seeks payment of "judicial interest" under Louisiana law, rather than some form of "contractual interest." Since no provision for the payment of interest appears in the policy, no *contractual rights* of FBT (even if it were an insured) could have been impaired.

In any event, the constitutional challenges which FBT attempts to raise in its Petition, including the argument that the Plan is an improper impairment of contractual rights, were placed squarely before the Pennsylvania Supreme Court in 1990 by other creditors of Mutual Fire who, unlike FBT, could point to actual *contractual* impairments as a result of the Plan. The Pennsylvania Supreme Court, agreeing with the findings of the Commonwealth Court, concluded that "[a]ny actual impairments are insubstantial" in light of the Rehabilitator's statutory charge "to effectuate equitably the intention of the rehabilitation statutes, i.e., to minimize the harm to *all* affected parties." *Foster*, 614 A.2d at 1094 (emphasis in original). The Pennsylvania Supreme Court concluded:

> Furthermore, the exigencies attendant to a major commercial insolvency and the goals of rehabilitation necessitate the reality that "individual interests may need to be compromised in order to avoid greater harm to a broader spectrum of policyholders and the public." *Vickodil v. Commonwealth, Insurance Department*, 126 Pa. Commw. 390, 559 A.2d 1010, 1013 (1989). See also *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 103 S. Ct. 697, 74 L.Ed.2d 569 (1983).

Foster, 614 A.2d at 1094.

In addition, both the Commonwealth Court and the Pennsylvania Supreme Court found that, even if any alleged impairments could be viewed as substantial, the Plan of Rehabilitation satisfied the requirements outlined by this Court in *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 103 S. Ct. 697, 74 L.Ed.2d 569 (1983), *i.e.*, that the state set forth a legitimate and significant public purpose and that the contractual adjustment be reasonable. The significant interest on behalf of the state in this case is to regulate the fiscal affairs of its insurers "for the welfare of the public" by equitably apportioning unavoidable loss. *Foster*, 614 A.2d at 1094-1095, n.4. Accordingly, the Plan's restriction on interest represents a reasonable balancing of individual interests with the "broader spectrum of policyholders and the public". *Foster*, 614 A.2d at 1094, 1102.

B. The Plan's Prohibition Against Interest Payments Does Not Violate Any Due Process Rights of FBT.

FBT also contends that the imposition of any Plan provision upon FBT constitutes a "retroactive application of substantive law" in violation of the Fourteenth Amendment to the United States Constitution. FBT failed to raise this issue in the Commonwealth Court; nor was it properly raised in the Pennsylvania Supreme Court as FBT failed to identify this point in its Statement of Questions Presented filed with the Notice of Appeal to the Pennsylvania Supreme Court. See Pa. R.A.P. 910 (only questions set forth in the Jurisdictional Statement will be considered by the Pennsylvania Supreme Court.) Accordingly, FBT's arguments, raised for the first time in its Petition, should not be considered by this Court.

In any event, FBT's claim that the Plan constitutes a "retroactive application" of substantive law is wholly without merit. While FBT repeatedly argues that its claim for judicial interest was a "vested" property right prior to the Supreme Court's Order affirming the Plan,[6] the same observation can be made of virtually all creditors of Mutual Fire who are asserting claims. For this reason, notice of the Plan of Rehabilitation was submitted to all creditors, including FBT, and all creditors were given an

---

[6] Contrary to FBT's claims, the Plan was approved by final Order and went into effect on January 23, 1990. Several creditors attempted to obtain a stay of the Plan; those requests were denied by both the Commonwealth Court and the Pennsylvania Supreme Court. Of course, FBT's judgment was not final until September 4, 1992.

opportunity to object and participate in hearings upon the Plan. FBT did not participate, although it had full opportunity to do so. Nor did FBT appeal the Commonwealth Court Order approving the Plan to the Supreme Court of Pennsylvania or to this Court.

Clearly, the Plan affects property rights, including "vested" rights, of creditors; however, all creditors were given the opportunity to challenge and litigate that Plan, and participate in a full and fair hearing in the Pennsylvania courts in satisfaction of due process and other constitutional requirements. *Mathews v. Eldridge*, 424 U.S. 319, 96 S. Ct. 893, 47 L.Ed.2d 18 (1976) (due process requires, at a minimum, that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case). In fact, in *Mathews*, upon which Petitioner relies, this Court held that the administrative procedures established for termination of Social Security benefits "fully comport with due process" and that a *pre-deprivation* evidentiary hearing was *not* required. In the case of Mutual Fire, the Insurance Commissioner and Commonwealth Court provided exactly what the Social Security recipient in *Mathews* unsuccessfully sought – a full-blown objection and hearing procedure *before* the Plan could be approved.

Finally, FBT states, in perfunctory fashion, that the Plan is unconstitutional "as applied" because its interest claim is substantial, and that the Plan "ignores controlling Pennsylvania and Louisiana Law and thereby violates due process." (Petition, p. 17.) However, FBT fails to explain how this Plan amounts to "class legislation," which this Court condemned in *Yick Wo v. Hopkins*, 118 U.S. 356, 366-367, 30 L.Ed. 220 (1886). Indeed, no such

comparison can be made since the Plan prohibits interest to *all* creditors and, in doing so, serves one of the principal purposes of the rehabilitation statutes – equitable apportionment of unavoidable loss. Moreover, while the result (barring interest) may conflict with "controlling Pennsylvania and Louisiana law," the compelling state interest and overriding public purpose behind the rehabilitation of insolvent insurers necessitate that "individual interests may need to be compromised in order to avoid greater harm" to all creditors and the public. *Foster*, 614 A.2d at 1094. Contrary to FBT's arguments, due process compels the result achieved in this case.

C. The Rulings of the Commonwealth Court and the Pennsylvania Supreme Court Which Prevent FBT From Seeking Interest From the Insolvent Mutual Fire Estate Do Not Violate the Full Faith and Credit Clause.

FBT argues in its petition that the Pennsylvania courts refused to give full effect to the Louisiana judgment in violation of the Full Faith and Credit Clause of the United States Constitution (Article 4, Section 1) and the dictates of this Court in *Morris v. Jones*, 329 U.S. 545, 67 S. Ct. 451, 91 L.Ed. 488 (1947). However, this is simply another label for the same argument advanced by Petitioner – that it is exempt from the Plan of Rehabilitation.

FBT's claim is not unique or different from the claims asserted by Pepsi-Cola and hundreds of other judgment creditors of Mutual Fire. Were Mutual Fire not in rehabilitation, the judgments held by those creditors might very well be merged to include the interest award for

purposes of collection. However, Section XVII of the Plan establishes a different rule of law for creditors with judgments against Mutual Fire, an insolvent insurance company in rehabilitation. That rule of law prohibits payment of interest, not only to judgment creditors, but to the thousands of policyholders of Mutual Fire, many of whom have also had to wait over eight years to receive full payment on their claims. Section XVII of the Plan clearly serves a very significant purpose, as it enables the Rehabilitator to achieve one of the most important goals of rehabilitation – the equitable apportionment of any unavoidable loss. *Foster*, 614 A.2d at 1091.

In *Morris v. Jones, supra*, this Court found that an Illinois liquidation court was required to give full faith and credit to the *amount* of a judgment obtained by a creditor in Missouri against the insolvent Illinois carrier. Significantly, this Court noted that the creditor's submission of his proof of claim in judgment form did not raise any question of "priority of claims against the property of the debtor." *Morris*, 91 L.Ed. at 494. Accordingly, "no question of parity of treatment of creditors, or the lack thereof is in issue." *Id.*

Unlike the creditor in *Morris*, FBT, in insisting that the part of its judgment which awards "legal interest" be given full faith and credit in the rehabilitation court, is raising a challenge to the priority of claims established in the Plan of Rehabilitation. As stated, FBT is arguing that it should receive preferential treatment by having its interest claim recognized in contravention of Section XVII of the Plan and ahead of the substantial claims of creditors in classes 5, 6, 7, 8 – claims on which *no principal* sums have been paid. Clearly, FBT's arguments deal

directly with matters of "distribution" and "determination of what priority" claims should have against the insolvent insurer, matters which this Court held are *not* subject to full faith and credit treatment. *Morris*, 91 L.Ed. at 494.[7]

D. The Plan's Prohibition Against Interest Is Wholly Consistent With the General Rule That Interest on a Debtor's Obligation Ceases When Receivership Proceedings Commence.

It is well established that interest on a debtor's obligations ceases to accrue when receivership proceedings commence. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 67 S. Ct. 237, 91 L.Ed. 162 (1946); *American Iron & Steel Manufacturing Co. v. Seaboard Air Line Railway*, 233 U.S. 261, 34 S. Ct. 502, 58 L.Ed. 949 (1914). Various exceptions to this general rule have been recognized (and codified under the Bankruptcy Code), such as payment of interest on over-secured claims and under circumstances in which the debtor becomes solvent. *United States v. Ron Pair Enterprises*, 489 U.S. 235, 109 S. Ct. 1026, 103 L.Ed.2d 290 (1989). The latter, the "solvency exception," provides that in the rare case in which an estate proves ample "to pay *all creditors* and to pay interest," equitable considerations may be invoked to permit the payment of interest.

---

[7] FBT insists, as it did in the Commonwealth Court, that its $1 million judgment and interest claim are "merged" and cannot be "split" into separate issues by virtue of the Plan or decisions of the Pennsylvania courts. Yet, while its appeal was pending before the Pennsylvania Supreme Court, FBT took just the opposite position in the Commonwealth Court, arguing that Mutual Fire should be required to pay the $1 million judgment while FBT pursued the "separate" interest issue on appeal.

Vanston, 329 U.S. at 164. *See also, John Nicholas, Trustee v. United States*, 384 U.S. 678, 86 S. Ct. 1674, 16 L.Ed.2d 853 (1966).

In *American Iron & Steel*, a case relied on by Petitioner, this Court explained at length the rationale behind the general rule that interest ceases to accrue when receivership proceedings commence:

> . . . [it] is a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full. If all claims were of equal dignity and all bore the same rate of interest, from the date of the receivership to the date of final distribution, it would be immaterial whether the dividend was calculated on the basis of the principal alone or of principal and interest combined. *But some of the debts might carry a high rate and some a low rate, and hence inequality would result in the payment of interest* which accrued during the delay incident to collecting and distributing the funds.

American Iron & Steel, 233 U.S. at 266 (emphasis added).

In *American Iron & Steel*, the debtor had achieved solvency and the dispute related to the order in which the trustees had paid interest to certain creditors. *That is certainly not the case with Mutual Fire*, as its current liabilities exceed its assets by over $400,000,000. While the Rehabilitator has achieved significant success to date and has been able to pay, on a proportional basis, all settled and adjusted policyholder claims, there remain hundreds of unsettled (and unpaid) policyholder claims against the estate. In addition, the claims of class 6 ceding companies for out-of-pocket payments alone exceed $200,000,000.

Clearly, Petitioner's request that it be paid over $1,000,000 in interest, in addition to the $1,000,000 policy payment that it has already received, completely ignores the concept of balancing of the equities. *Vanston*, 329 U.S. at 165. Mutual Fire's assets are insufficient to pay the full principal amount on the thousands of remaining claims being asserted against the estate. In order to pay interest which has accrued during the pendency of the rehabilitation to Petitioner and thousands of previously-paid class 4 claimants, the Rehabilitator would have to seek the return of principal payments already made to policyholders, which would create an entirely unworkable and inequitable situation. The principles established by this Court in *Vanston* and *American Iron & Steel* were designed to prevent just that, *i.e.*, a situation in which creditors asserting claims with different rates of interest could exhaust the limited funds of an estate.

Each of the cases cited by FBT in its Petition involves either debtors that became solvent and were able to pay *all* claims, or creditors with claims that were over-secured. *See, for example, Ticonic Nat'l Bank v. Sprague*, 303 U.S. 406, 82 L.Ed 926 (1938) (exception noted for over-secured creditor who was entitled to interest); *In re Sublett*, 895 F.2d 1381 (11th Cir. 1990) (exception made for creditor whose claim was over-secured); *In re D.C. Sullivan*, 929 F.2d 1 (1st Cir. 1991) (presented "rare case," since debtor became solvent during the course of the proceedings).

FBT further argues that the Pennsylvania Supreme Court, in approving the Plan, created an additional creditor class at footnote 13 of its Opinion (a class of creditors with interest claims) at the same time that it approved

Section XVII's *prohibition* of interest payments. According to FBT, it was entitled, by virtue of that footnote, to receive payment of its interest after payment of the principal on class 4 claims, but *before* any principal is paid on classes 5 through 10. (Petition, pp. 8-10.) In effect, FBT is suggesting that this Court should review this matter because the Pennsylvania Supreme Court, in FBT's view, has issued conflicting opinions.

FBT's arguments simply do not belong in this Court and are a strained effort to create federal questions where none exist. In any event, its assertions cannot be reconciled with any fair or reasonable reading of *Foster*. That Court did not create or sanction such preferential treatment for FBT or any other creditor. Rather, its holding with respect to Pepsi's challenge to Section XVII was clear and straightforward – while interest expressly awarded in connection with pre-rehabilitation judgments (as was the case with Pepsi's federal court judgment) "must be accepted and given dignity up until December 4, 1986," interest which accrues after that date is properly denied under Section XVII. *Foster*, 614 A.2d at 1102.

In footnote 13 of its Opinion, the Court in *Foster* observed only that this *result* – "disallowing the payment of interest on Pepsi's judgment *for any period beyond the date the petition of rehabilitation* was filed" – is consistent with decisions in this and other courts which (even where no plan or formal prohibition of interest existed) held that interest accruing after commencement of insolvency proceedings could be payable, if at all, only after the principal on *all* claims has been paid in full. *Foster*, 614 A.2d at 1102, n.13.

The effect of granting the relief which FBT requests would be to create an intermediate class between class 4 and class 5, a class of which FBT would be the only member. There is certainly no basis under the Pennsylvania Insurance Department Act, the Plan or the United States Constitution for singling out FBT as a creditor deserving of preferential status when it comes to the distribution of Mutual Fire's limited assets. Indeed, FBT is demanding that the Rehabilitator and this Court ignore her statutory charge to "equitably apportion" any unavoidable loss and to protect the interests of *all* creditors, policyholders and the public.

CONCLUSION

For the foregoing reasons, it is submitted that the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

RICHARD DISALLE, Esquire
Counsel of Record
MARY LYNCH FRIEDLINE, Esquire
ROSE, SCHMIDT, HASLEY & DISALLE, P.C.
900 Oliver Building
Pittsburgh, PA 15222-2310

Attorneys for Respondent, Linda S. Kaiser, Insurance Commissioner of the Commonwealth of Pennsylvania, as Rehabilitator of The Mutual Fire, Marine and Inland Insurance Company